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Russia nursing \$20 billion newbuilding plan for fishing fleets renewal / November 21, 2011 08:17

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According to fishing fleets' managers Russia is virtually facing a situation of forthcoming rapid fleet decline because of old age and condition of the fishing boats unless urgent measures are taken to rectify the problem. So far the options explored to take the challenge have had to do with rebuilding, conversion and refitting. For example, Pacific Andes, very active in an indirect way in Russian pollock fisheries, has recently preferred to extend the hull of a BATM large trawler, convert an old tanker to a mothership and start refitting the 10 year + old Victoria floating processor currently rusting in China. The fast growing Karat Group (the new owner of Kamchatka-based Akros) has sold two old boats to buy a 15-year old supertrawler. However neither rebuilding nor purchase of second-hand vessels is an adequate answer to the threat. Could an international solution be found for the huge task by combining the forces of the newly-formed giant United Shipbuilding Corporation (Russia) and, let us say, Norwegian yards?

A highly experienced veteran of Russia's fishery industry **Georgy Zaytsev** shares with **MegaFishNet.com** his vision of the scope of the challenge

looking both into the hurdles and opportunities of the \$20 billion newbuilding plan for the industry to maintain the current catch and live up to the target of 5.5 million tonnes of fish catch as of 2015.

Shipbuilding is a buzzword in present-day Russia. It is often repeated by President Medvedev and Prime Minister Putin at the meetings with governors and fishery experts while on inspection tours of Russia's regions. Such a frequent usage of this term by top leaders of the country reflects their serious concern regarding the poor state of Russia's fishing fleet. Most of the fishing vessels are old and obsolete and suffer from mechanical problems, sometimes they are barely seaworthy. Few years more, and the large number of trawlers and seiners will have to be written off and sent to the scrap yard. So it becomes obvious to everybody that an urgent renewal of the fishing fleet is a must. Otherwise, Russia would cease to be a world fishing power and would be deprived of the fishing rights in many parts of the World Ocean. If that had happened, it would have been a humiliation to the country's fishing community and a threat to the national food security. According to the official document called the **Doctrine of food security of Russia** (adopted in 2010) the import of fish to the country must not exceed 20%, which means that the remaining 80% of fish consumed by Russia's population must be caught by the Russian fishing vessels.

However, the costs of the total renovation of the Russian fishing fleet could be huge. In his book **"From Cape Hatteras to Cabot Strait"** (NOAA publication, 2006) the late Yuri Chuksin, a Russian scientist, wrote: "According to calculations, nearly 1,120 new fishing vessels of different classes must be brought into operation in order to take a 5.5 million t catch in 2015. This will require USD 20 billion capital costs".

In order to give an idea of the scale of the problem the Russian fishing industry faces, a brief round-up of the present state of the Russian fishing fleet is needed. According to Andrei Krayniy, Chief of the Federal Fisheries Agency, during the last six years the Russian fishing fleet has shrunk by 666 vessels which were taken out of service due to the old age. At the same time no significant equal replacement was registered. As an example, 252 fishing boats were decommissioned in 2008 - 2009, but only 68 vessels joined the fleet at the same period of time, and only 2 of them were newly built vessels, others - second hand units. According to the same source, the Russian fishing fleet numbered 2,419 vessels of different types and purpose as at 1 January 2010 (statistical data as at the beginning of 2011 not available yet) including:

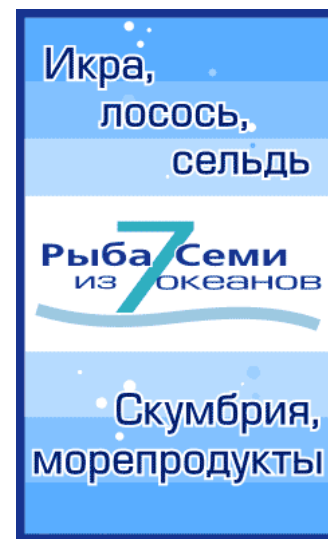
Catching fleet - 2,067 vessels;

Fish processing fleet - 23 vessels;

Transport fleet - 269 vessels;

Research vessels, cadet training ships, patrol boats - 60.

All the above information was disclosed by Mr. Krayniy in Vladivostok about 8 months ago where he took part in the Conference whose theme was announced as «On the construction of the fishing fleet for the needs of the fishery complex of the Russian Federation". Obviously, he was well prepared for the above Conference and his figures are absolutely reliable. Unfortunately, he did not sound very optimistic, and one of his last remarks at the above event was even gloomier, than the previous ones. He claimed that ninety percent of the existing vessels used in fishing operations practically exhausted their service life and are eligible for decommissioning (source: *Fish Resources*, June 1, 2010). As it has turned out, the ageing of the Russian fishing fleet worries not only Russians, but Norwegians as well. The company **"Norwegian Technology Suppliers"**, based in Kristiansund N., took the trouble of carrying out its own independent study on the age-wise distribution of the fishing vessels (catchers) in the north-western fishery basin of Russia. The fleets of this basin are registered in St. Petersburg, Kaliningrad, Murmansk, Arkhangelsk, the Republic of Karelia, and the Nenets Autonomous District. The limited format of this article does not permit to reproduce the Norwegian study in full on these pages, and only the most important and interesting facts are quoted below. According to the study, the total number of fish catching vessels (built in the USSR/Russia and at foreign shipyards), registered in the north-western basin stands at 300 units, including 50 big and very big vessels (overall length between 70 and 120 m), 156 medium vessels (overall length between 40 and 65 m) and 94 small vessels (overall length between 25 and 39 m). The average age of the vessels built in the USSR (**group no.1** in the study) is 23.3 years. In authors' of the study opinion, the youngest and still operationable in this group are big fishing trawlers of the "Pulkovskiy Meridian" type (18 vessels) with the average age of 20.9 years. **Group no.2** of the study includes fish catching vessels built at foreign ship yards in Soviet times. The age range of the vessels of this group varies between 18 to 29 years, the average being 23.2 years. The most promising in this group are big fishing trawlers of the "Moonsund" type (15 vessels) whose average age is 19.6 years. **Group no.3** of the study includes 6 medium vessels (SRTM type), built in the post-soviet period under credit arrangements granted to private shipowners. These vessels are still in good repair, the average age being 11.8 years. And at last **group no.4**, which comprises all other vessels which do not fall into the three previous categories. The vessels of this group were acquired

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by private Russian companies in the post-Soviet period on various terms including the bareboat charter arrangements. These are mainly small boats of different types, definitely not serial ones, designed for catching bottom fish and crabs in the Barents Sea. These fishing vessels, all foreign built, number 46 units and their age ranges within 7 to 42 years, the average being 27.7 years. (Source: *Fish Resources*, no.3, 2010).

The Norwegian study was confined only to the Russian fishing vessels' age in the north-western basin of Russia. But, according to reports of the Russian fishery experts from the Far East, the situation with the fleet's ageing there almost mirrors that of the European part of Russia. Russian own analysis shows that the worst hit by old age and high tear and wear are big and very big vessels. Those 33 fishing trawlers of "Pulkovskiy Meridian" and "Moonsund" types, mentioned in the Norwegian study as being in more or less good form, are not obviously sufficient to keep Russia's presence in the far-away areas of the World Ocean, such as the Southeast and Southwest Atlantic, Southeast Pacific, etc. As always in hard times, two eternal questions have popped up in Russia once again: **Who is responsible (or guilty) ?** and **What is to be done ?**

The answer to the first question is - nobody. Nobody is guilty of bringing the whole fishing fleet of the country to the brink of ruin by not providing the timely replacement of the ageing vessels with new ones. To understand why a recurrence to the past is inevitable. Not so long ago, in Soviet times, the State was the real owner of all fishing vessels in the country (except some small boats owned by cooperatives). The vessels were run by several state-owned companies-operators whose responsibilities were to plan fishing operations and monitor their fulfillment by every vessel, to organize supply of vessels with fuel, provision, fishing gear etc., to recruit crews, and arrange timely repairs of the fleet. It was also their responsibility to effect depreciation payments, i.e. transfer money to the so-called depreciation funds where it was accumulated and then used by the State for purchasing new vessels. The strategic nation-wide planning of the country's economy was carried out by Gosplan (the State planning committee). This mighty organization, controlled directly by the Council of Ministers of the U.S.S.R., set plans for everything, including, of course, the development of the fishing fleet - the construction of new vessels, their types and number, their distribution among the companies-operators, and the timely substitution of old vessels with the new ones. So, if the present critical situation with the renewal of the fleet had happened in Soviet times, the blame for this would have been laid on Gosplan. After the collapse of the U.S.S.R. almost all the fishing fleet was privatized, except scientific research vessels, patrol boats, and cadet training ships. One commercial fishing company in Arkhangelsk also avoided privatization (Arkhangelsk Trawl Fleet is also on privatization agenda now). The privatization of the fishing industry in Russia resulted in fragmentation of the fleet. If in Soviet times only 63 fish-catching and fish-processing enterprises were engaged in fisheries all over the country, nowadays, after the privatization, the number of players in the fishing business exceeds 2,700, including 1,784 fish catching companies (source: *ITAR-TASS news agency*, February 2, 2011). Most of these companies are small, sometimes a one-man, one-boat show. It goes without saying that no such organization as Gosplan exists any more, and the planning of the day-to-day and future fishing operations is left at the discretion of private owners. They decide whether to run on and on their vessels until they fall apart and collapse, or to try and save some money generated by the profits in order to be able to buy new vessels instead of ageing ones.

The second question - **what is to be done** - is not as easy to answer as the first one. Before signing a building contract with a shipyard a potential buyer must pass through several preparatory stages. First of all, he must decide for himself how many new vessels he needs and their types. Then, a new vessel's design must be drawn up, the job, usually done by a firm of naval architects. The next stage, the most important one, is to find out a source of financing of vessels' construction. If the first two abovementioned stages do not need any comments, the subject of financing deserves to be dealt more deeply. All imaginable sources of financing may be divided into the following categories: 1. Buyers' own funds (if any) for outright purchase; 2. A State budget; 3. Bank loans; 4. Leasing arrangements; 5. Sponsors/investors. Let us consider these categories one by one.

1. Buyers' own funds

As was mentioned above, the bulk of the fishing industry comprises small private companies. They are usually preoccupied with their daily problems and current running costs of the vessels. Probably, some of them save money for the future development, but it can be assumed with a high degree of certainty that they do not have enough funds to order a big modern trawler. At best some of them can afford buying a small or medium vessel. There are also a few large fishing companies in the country which have means sufficient to buy big and very big vessels. And they do it from time to time buying one or two units, mainly at foreign shipyards.

2. A State budget

In a free market economy it would be naive and even stupid to expect that the State would provide a full financing to private companies necessary for the purchase of new vessels. The main task of the State is to establish the legal "rules of the game" and create favourable conditions for the fishery business functioning. The renewal of the fleet is the problem of private shipowners. However, the Government could, and should, help the fishery entrepreneurs, provided such a help does not contravene principles of a free market economy. The forms of the State support could be various economic entitlements, such as customs exemptions, tax break, grants, etc. Presently, the Russian Government offers fishermen subsidies to cover banks interests. However, these subsidies can be given only to those companies, which borrowed money from the Russian banks. The total amount allocated in the State budget for this purpose is Roubles 150.6 million, or about USD 5 million in equivalent (source: *eTver.ru*, February 11, 2011). Obviously, this is not a big deal.

3. Bank loans

As a rule, banks are interested to attract as many borrowers as possible because crediting is one of the most lucrative lines of their business. But to satisfy a borrower's application for a loan, banks need some kind of a financial security. The common term of a loan is that part of a borrower's property - his vessels and/or other assets (for example, an office building) are to be mortgaged to a bank. However, not every vessel is eligible for a mortgage - only those not older than 2 - 3 years. So far as the country's fishing fleet consists mainly of old vessels, it is practically impossible for most of the shipowners to meet this requirement. As for their buildings and offices, in most cases they are also of low value and can hardly compete with Russian oligarchs' castles and villas. In this situation many Russian fishermen come up with an idea to offer fish quotas as a mortgage. Of course, some questions arise regarding this proposal. For example, what happens in case of a default ? How then can a bank get its money back in practical terms? However, the above idea should not be discarded at once. By the way, there was a precedent in the past when fish resources, i.e. fish in the water, was accepted as a share capital of one of the partners of a joint venture company with the participation of a Soviet organization. In 1978 the Soviet foreign trade company **Sovrybflot** came into an agreement with **Emopesca**, a state-owned fishing enterprise in Mozambique, to create a joint venture **Mosopesca**. The share capital of this new company was formed in the amount of USD 16.5 million, the Sovrybflot contribution (four fishing trawlers of SRTM type plus cash) being 49% , and the Emopesca share (four fishing vessels plus office building ashore plus cash) - 51%. **Sovrybflot** fulfilled its obligations in full having brought 4 vessels to Mozambique and transferring money to Mosopesca's bank account. But the partner managed to bring only 2 vessels, instead of four. So far as there was a deficit in the Mozambican share, **Emopesca** proposed to cover the above deficit by contributing fish resources of Mozambique's EEZ (quotas for 150,000 t of fish and 13,000 t of prawns) valued at USD 2.3 million. So far as the negotiations went too far, **Sovrybflot** had no other option but to agree to this proposal.

4. Leasing arrangements

Leasing operations are widely used in many countries of the world and are not new to the Russian enterprises from various sectors of Russia's economy. If applied to the construction of fishing vessels, a leasing scheme includes not only the financial component of a deal but also the bareboat charter arrangements that provide for the timely and regular repayment of the loan after a vessel is built and entered into fishing operations. To put it briefly, under bareboat charter the vessel is given to the client with no prior payment (except a mandatory down-payment - usually 15% from the contract amount). The latter (client) is simply required to pay a part of a total loan plus a bank interest on the part of the catch sales. A repayment schedule could be 6 - 12 years. Once the payments have covered the loan and bank interest in full, the vessel becomes a client's property. The most advanced system of leasing is offered in Norway. In this country, in order to support the national producers, including those from a shipbuilding sector, two specialist organizations were created - **Eksportfinans** (a private company owned jointly by the State and several Norwegian banks) and **GIEK** (a state-owned institute of export crediting authorized to issue a state guaranty to financial organizations). If a Russian shipowner (buyer) wants to place an order with one of Norwegian shipyards, he becomes eligible to be covered by the Norwegian system of export financing. The buyer signs a building contract with a shipyard and a loan agreement with **Eksportfinans**, then **GIEK** issues a State guaranty, and there is no need for the buyer to provide any

kind of additional financial security. Instead, the vessel under construction will serve as a mortgage. However, as was mentioned above, 15% of the contract value must be prepaid by a buyer in cash. The contracted shipyard will get payment for the remaining 85% of the contract amount from **Eksportfinans** immediately on signing all formal documents. This is a brief and schematic description of the leasing system available in Norway. Similar arrangements are offered in some other countries, for example, in Spain. However, there is a snag in this otherwise perfect financial construction. This is a mandatory down-payment, i.e. money transfer of the 15% of the contract value by a buyer to a shipyard's bank account on contract signing. Assuming, as an example, that the costs of a big trawler construction were agreed at USD 50 million, the down-payment will then amount to USD 7.5 million. This could be a hurdle, impossible for the most of the Russian shipowners to get over without outside support. And it does not matter whether it is a Russian or foreign supporter.

5. Sponsors/investors

Fishing business can be very profitable under certain conditions. But at the same time it is considered as being too risky because it is vulnerable to many factors outside man's control. These factors include, for example, bad weather, availability and abundance of fish stocks, prices for fish at world markets, etc. So, generally speaking, finding a sponsor is a matter of chance, sometimes depending on personal contacts and trust. There is also a category of the so-called business angel - a private investor who not only finances small companies but who also gives them the benefit of his or her own expertise (source: *Financial Times glossary*). Seventeen years ago one such angel landed in Petropavlovsk Kamchatskiy in Russia. His name was Arne Larsson, owner of **A.L. Shipbrokerage Ltd.**, London. In 1993 he bought a 64 metre factory trawler at the **Sterkoder Shipyard** in Norway as an outright purchase and named her *Iolanta*. Mr. Larsson, being owner of the vessel, decided to bareboat charter the *Iolanta* to a small and a relatively new fishing company **Kamchatimpex**, giving the company a chance to get the trawler as its property as soon as the bareboat charter contract is fully repaid.

Having considered various options of financing, we move now to the equally thrilling subject of shipbuilding. Every now and then headlines in local newspapers and reports on the radio and TV inform the general public on the latest achievements of the Russian shipyards. On the list of newly built vessels are, for example, 'stealth-type' warship and several frigates for the Indian navy, diesel-electric and nuclear-powered icebreakers, oil and chemical tankers, various offshore service vessels for oil and gas sectors, etc. This is, of course, positive information, which creates the impression that shipbuilding is a thriving and successful sector of Russia's economy. Unfortunately, this is not the case. Shipbuilding, like some other industries of the country, is burdened with many various problems, such as too high labour intensity, the shortage of qualified personnel, high tear and wear of shipyards' equipment and mechanisms, the lack of technological components, etc. The fact of a poor state of the Russian shipbuilding industry was publicly acknowledged by Prime Minister Putin. During his visit to the **Admiralty Shipyard** in St. Petersburg in May 2008 he said: "... foreign ships are built faster, are of a higher quality, and importantly - are still cheaper". This deplorable situation can be, at least partly, explained by the disorganization of the country's economy after the break-up of the Soviet Union. The large-scale privatization caused a rift within the previously harmonious structure of the industry. While some of the yards, mainly from the military-industrial complex, remained state-owned and controlled directly by the Government, those privatized ones got the freedom of action and became able to make their own decisions on everything including choosing the potential contractors, etc. The state has no right to intervene in their economic activity. As a result, the total shipbuilding capacity turned out to be deconsolidated and difficult to coordinate. But the most painful blow for the industry was the sudden loss of seven modern and efficient shipyards. No, they were not destroyed by fire or by some other calamity. They are still on the sites where they had been built in Soviet times. But they belong now to foreign countries: one - the **Baltija** Shipyard in Klaipeda - to Lithuania, the other six - to the Ukraine. It must be mentioned that the **Baltija** shipyard and two of the Ukrainian shipyards - **Ocean Yard** and **Black Sea Shipbuilding Yard** (both in the city of Nikolajev) - were the main manufacturers of big factory trawlers launching each about 12 vessels every year.

From a technological point of view those shipyards that remained in Russia can be divided into two groups. Group one - small shipyards capable to produce medium-sized craft with certain limitations as to the vessel's length and draught (note: most of these shipyards are situated inland on rivers, without a direct outlet to the sea). Group two - larger shipyards with facilities (building-on ways, dry docks, etc.) permitting the construction of big and very big vessels. It is quite possible that shipyards of the group one will be able to satisfy the needs of the fishing industry in medium and small fishing vessels. These shipyards, for example, **Yaroslavl Shipbuilding Plant**, **Zelenodolsk Shipyard**, **Khabarovsk Shipyard**, and others, are working successfully producing vessels of various types and purpose including fishing boats. So the problem of renewal of the medium and small fishing fleets does not look as very acute. As for the construction of big factory

trawlers, it is a different story. Shipyards from the group two can be counted on the fingers of both hands (and this is not many for such a big country as Russia), and none of them had a history (and expertise) of building big factory trawlers. Instead, three shipyards in St. Petersburg, one in Kaliningrad (**Yantar Shipyard**), one in Vyborg, and few others have been, for many years, engaged in construction of submarines, destroyers, and other types of warships for the Russian Navy and for foreign fleets, various tankers and ice-breakers, dry cargo ships, bulk carriers, and offshore service vessels. And most of them are still busy handling new contracts. With the development of the offshore gas and oil fields in the Arctic Ocean, the prospects are even brighter. No doubt, more orders, especially for semi-submersible drilling rigs (SS), pipe carriers (PI), floating production, storage and offloading vessels (FPSO), and others, will follow. Unfortunately, the wide product range of the above shipyards does not include fishing vessels, although some sporadic orders for boats of various types (except big trawlers) had been won in the past. Thus, in 1959 - 1968 the **Baltic Shipbuilding Plant** built several reefers (projects 581, 581T and 581Y). Another giant of the shipbuilding industry in St. Petersburg - the **Admiralty Shipyard** - launched several fish canning and fish meal motherhips (projects 398, 398 P, 400 and 413) in 1965 - 1972. The same shipyard built several small 25 meter shrimp trawlers in 1993. Worth mentioning also is the contract of the Kaliningrad-based **Yantar Shipyard** with the Norwegian yard **Umoe Sterkoder AS**. The contract provided for the construction of two 70.5 metres trawler hulls, which, on completion, had to be towed to Norway for outfitting. Both hulls were launched in 2001 - 2002. A similar job was done by the **Vyborg Shipyard**. In 2001 this yard built three trawler hulls for the Norwegian company **DOF Industries AS**. Against this poor background the **Zvezdochka Shipbuilding Plant** (situated in Severodvinsk, northern Russia) outshined other shipyards. In 1998 - 1999 **Zvezdochka** (Little Star in Russian), originally designed for the repair of nuclear subs, built several 38.5 metre factory freezer trawlers (project 50010). However, this was not a solo part, but rather a joint venture with Norwegians, because some of the vessels' equipment, such as fish factory, refrigeration plant and part of navigational and fishfinding electronics was fitted out onboard the vessels at the Norwegian shipyard **Kimek** in Kirkenes. Besides, the trawler of this project does not fall into the category of big trawlers because of its length (38.5 metres overall). So, unfortunately, no evidence of previous involvement of the existing Russian shipyards in construction of big trawlers is available. And it casts some doubts on their capability to build a big fishing trawler from zero to a turn-key stage. Of course, the yards have modern shipbuilding facilities, but they lack the knowledge needed to produce fishing vessels. Experience and expertise mean a lot when a big modern fishing trawler is being built.

There are also few additional factors which could have a negative effect on the possibility of construction of big fishing trawlers at the Russian shipyards. One is the lack of technological components of the Russian origin which causes the necessity to import the major content, perhaps as much as 30 - 40 %, of a vessel - the main and auxiliary engines, navigational and fishfinding equipment, refrigerating systems, etc. Another factor is the rising competition among shipyards for the lucrative orders of oil and gas sectors. As a result, an order for a fishing vessel might remain in shadow and could be considered by a shipyard only if no orders for offshore service fleets are available. It is going to be a sort of a trend now and not only in Russia, but in Norway as well. Arild Aarvik, owner of the Norwegian company **Carisma Fish**, claimed that Norwegian shipyards are more interested in orders from the oil and gas industry than in orders from fishermen (source: *Rybatskaya gazeta*, November-December 2008) .

The above superficial analysis of the present state of the Russian fishing fleet and of production capacities of the shipbuilding industry permits to draw the following conclusions:

1. It is impossible for the Russian owners of fishing vessels to respond positively to the patriotic appeal to build new big trawlers only at Russian yards. First, they (yards) do not have a proper expertise. Second, most of them are already bound by commitments to build vessels for the Navy and oil and gas sectors. Even assuming that the yards solve the problem of expertise by recruiting the experienced personnel and buying some additional equipment, their possibilities will still remain limited. For example, the **Yantar Shipyard** in its company's presentation claims that the yard is capable to build 3 - 4 big factory trawlers per year (source: *Fishnews*, no.3, 2010). The remaining 6 - 7 Russian yards will hardly do better because they are fully booked for the next two years with orders from the defense and oil and gas industries (source: *RIA Deita.ru*, December 28, 2010). So their combined yearly output (including that of **Yantar Shipyard**) would hardly amount to 15 - 18 vessels at best. However, the number of new big trawlers to be built within the next several years is evaluated at 365 vessels (source: *Rybnoye Khozaystvo*, no. 6, 2009). It would mean that the total renovation of the fleet of big trawlers would be finished in 20 - 24 years. Obviously, in the present situation such a rate of renovation is unacceptable, and the Russian shipowners will be forced to place orders for new vessels with foreign shipyards. Of course, this does not exclude the possibility of the Russian shipyards' involvement in mass production of the fishing vessels if and when they are ready to participate.

2. Obviously, such a large-scale fleet renovation programme can not be carried out without a strong financial support of the State. At the beginning of this article (in the second paragraph) the total costs of the fleet renovation were estimated at USD 20 billion (that was a quotation from the book "**From Cape Hatteras to Cabot Strait**"). Let us take this figure for granted (although it has, probably, to be checked). This is a hell lot of money and it could be difficult even for the State to collect it to finance the programme. However, under the leasing/bareboat charter scheme of financing not the full sum of USD 20 billion will be required but only 15% of it to be paid up front. The balance will be covered by bank loans that are to be repaid later when the newly built vessels start fishing and earning money. Of course, 15% or USD 3 billion is also a huge amount. As was explained above, none of the Russian shipowners will be able to effect down payment with their own money. And that is where the State can help fishermen to build new vessels. Indeed, the fishing industry, designated a strategic sector of the country's economy alongside the nuclear industry, arms production and sale, aerospace, geological prospecting, and oil and gas exploration and production, deserves the generous State's support. At stake is the food security of the country. After all, USD 3 billion is not so much if compared with billions of dollars injected into the country's banking system after the last financial crisis few years

ago. Also very important for the State to urgently create a financial structure of leasing/bareboat charter arrangements similar to that in Norway as described above. If such a structure works successfully in Norway, why should it not work in Russia.

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